Energizing Trade of the States of the Former USSR

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For the 15 newly independent states of the former USSR, transitional trade and payments arrangements are urgently needed to stop the precipitous decline in trade. Next steps should include a sharp cut in export controls, a reduction of state trading and a parallel expansion of inter-enterprise trading, and the development of multilateral clearing and payment mechanisms.

Since August 1991, the 15 states of the former USSR have been establishing themselves as independent nations, each embarking upon systemic reform on a different scale and at a different pace. But with a new incentive structure that discourages trade among the states of the former USSR (so-called interstate trade) and without the necessary institutions to facilitate trade, trade relations among the states have been thrown in disarray, at times verging on a collapse.

Interstate trade had traditionally accounted for the bulk of total trade of the states of the former USSR. Russia was the least dependent, with trade with the other states accounting for 61 percent of its total trade in 1990, compared with over 80 percent for the others (see table). In the aftermath of the breakdown of the USSR, precise data on trade among the New Independent States are not available. But preliminary estimates suggest that interstate trade declined by over 30 percent in 1991. Ominously, further substantial drops in this trade are widely reported for 1992 and the outlook for 1993 is grim.

Of course, some decline in trade flows was expected. After all, for the past 40 years, as in Eastern Europe, trade among these countries was not based on economic principles of comparative cost and locational advantage. Indeed, studies indicate that in the years ahead, these economies can be expected to (1) trade less with each other and more with other countries, notably those in Western Europe, and (2) import more machinery products and export more raw materials and metal products. Unlike Eastern Europe, the former Soviet states must now struggle not only with serious payment problems but also a lack of monetary coordination among those states still using the ruble, and uncertainty surrounding the creation of new currencies.

The main worry now is that the continued contraction in interstate trade will contribute to further declines in output and incomes. Thus, policymakers need to adopt transitional mechanisms that would help states restore efficient trade flows and avoid further serious disruptions of trade flows in the short term, while supporting their longer-term adjustment and integration into the world economy.

Major causes for concern

Throughout 1992, an almost chaotic situation characterized trade and payments in the former Soviet states, reflecting a variety of problems. At the root was the collapse of the monetary and payments system.

Payments regimes. During the first six months of 1992, Russia alone could print rubles, but the central banks of all the states in the ruble zone could expand the money supply by creating credit in rubles. In the absence of monetary coordination, this quickly gave rise to a "free rider" problem, because monetary restraint by some central banks could be exploited by others able to expand their money supply independently. Not only did this situation contribute to inflation but it also impeded efforts to stabilize the ruble and

For a fuller discussion, see "Trade and Payments Arrangements for States of the Former USSR," by the authors, Studies of Economies in Transformation No. 2, *The World Bank, 1992, available from World Bank Publications Services.*

posed difficulties for trade and payments. It did so by creating a disparity in incentives to export between enterprises and for the economy as a whole. Assuming enterprises felt they had as much chance of getting paid (in rubles) when exporting to another state as when selling in the domestic market—not always a valid assumption—they would be indifferent as between the two markets; but for the country as a whole, it would be less advantageous to exchange goods for rubles—after all, its central bank could create all the rubles it wanted.

As the year wore on, Russia, notwithstanding its own considerable monetary expansion, accumulated a significant trade surplus with other republics. This reflected, in part, traditional structural relationships and, in part, the relatively large upward adjustment in the price of oil—Russia's main export. To stem the outflow of goods and control the provision of credit to other states, Russia established a network of correspondent accounts for the central banks of the states, which monitored all bilateral transactions; after July 1992, credit limits were imposed on these accounts. When a country exceeded its limit, the Russian central bank would refuse to clear payments orders (like checks) of enterprises in the debtor country, meaning that Russian exporters would not be paid for the goods they shipped to that republic.

Exacerbating matters was the dramatic decline in the efficiency of the interstate banking system following the dissolution of the Gosbank, once the central bank for all the states. Exporters and importers found that it took two to three months to clear payments orders—a risky business in an environment of high inflation.

At the same time, several countries—such as Ukraine and the Baltic states—introduced their own currencies or quasi-currencies. Others plan to do so in the near future. New currencies do not pose a problem for trade, so long as they are convertible for trade transactions. But if they are not, these states will have to develop clearing and payments arrangements that support direct enterprise-to-enterprise trade. Otherwise, trade among enterprises will continue to be quite inefficient, as it would be based on barter and state-to-state agreements.

Trade regimes. Perhaps the most significant trade barrier—both for interstate and convertible currency area trade—is the widespread use of export licenses and quotas. The motivation for these controls derives from two main considerations:

- Given a lack of monetary coordination within the ruble zone, each country has a strong incentive to import goods and pay for them in rubles, which their central banks can create independently. One way countries can guard against this is to impose quantitative limits on exports.
- Given that the extent of price liberalization has varied greatly from state to state, there are significant price differences in a number of products. Moreover, many prices, notably for energy, are still well below the world level. Without export restraints, such products would be exported to world markets, or to other republics who have higher prices.

On the import side, formal restraints are quite low, as licensing has largely been removed and tariffs are either low or not applied. Competition from abroad is nonetheless weak, because those who must pay market rates for foreign exchange purchase foreign exchange with a substantially undervalued ruble. There are extensive foreign exchange subsidies, but these are available only on non-import-competing products.

Given prevailing market rates of the ruble to the US dollar in most states in 1992, workers have been earning only about 10 US dollars a month, demonstrating the very high value of convertible currency and the high cost of imports at market exchange rates. The undervaluation of the ruble is caused by a number of factors, most notably (1) policies that discourage the repatriation of foreign exchange, such as real interest rates that have remained negative, frequently by 50 percent or more; and (2) policies that discourage exports for convertible currency. The latter include licenses and taxes on exports, along with requirements to surrender foreign exchange earnings at rates much lower than those prevailing in the free market.

State trading through bilateral arrangements. In an effort to deal with interstate trade problems, countries have resorted to many of the features that characterized trade under central planning. By March 1992, an extensive network of intergovernmental bilateral trade agreements had been signed, dividing trade into three categories: "obligatory," "indicative," and enterprise-to-enterprise.

Obligatory list trade entails the intergovernmental barter of 100–150 of the most important energy products and raw materials. Commitments obligate states to fulfill their contracts, and maximum allowable prices are usually specified. Indicative list trade typically includes up to 1,000–1,500 products, such as machinery, agricul-

Intraregional trade looms large in the former Soviet states

	Foreign trade		Share of intraregional trade
	Total [1]	Intraregional [2]	
	(percent of GNP)		
States of the former USSR (1990)			
Russian federation	18.3	11.1	60.6
Ukraine	29.0	23.8	82.1
Belarus	47.3	41.0	86.8
Uzbekistan	28.5	25.5	89.4
Kazakhstan	23.5	20.8	88.7
Georgia	28.9	24.8	85.9
Azerbaijan	33.9	29.8	87.7
Lithuania	45.5	40.9	89.7
Moldova	33.0	28.9	87.7
Latvia	41.4	36.7	88.6
Kyrgyzstan	32.3	27.7	85.7
Tajikistanian Republic	35.9	31.0	86.5
Armenia	28.4	25.6	90.1
Turkmenistan	35.6	33.0	92.5
Estonia	32.9	30.2	91.6
Eastern Europe (CMEA) (1989)			
Bulgaria	30.1	16.1	53.4
Czechoslovakia	23.0	10.9	47.2
Hungary	34.1	13.7	40.3
Poland	19.6	8.4	43.1
Romania	17.6	3.7	21.0
European Community (EC) (1990)			
Belgium	74.2	44.5	60.0
Denmark	32.7	13.7	41.7
Germany	29.8	14.4	48.2
Greece	26.8	13.3	49.4
Spain	19.8	9.0	45.3
France	23.3	13.0	55.6
Ireland	59.9	38.9	64.9
Italy	20.4	9.7	47.5
Netherlands	54.4	34.2	62.9
Portugal	42.1	24.6	58.4
United Kingdom	26.0	10.7	41.2

Sources: States of the former USSR: Goskomstat for trade data in foreign trade prices, and unpublished World Bank estimates for GNP; Eastern Europe: UNECE (1990) for trade data, and World Bank Atlas for GNP; Pisani-Ferry and Sapir for the EC. 1990 data are used for the states of the former USSR and the EC; 1989 data for Eastern Europe.

[1] Average of exports and imports as a percent of GNP.

[2] Trade within the states of the former USSR, the CMEA, and the EC, respectively.

tural, and consumer goods. Such trade differs from the obligatory kind in that, although in both cases states agree to provide licenses for enterprise contracts up to the quota amounts specified in each protocol, no trade will take place unless individual enterprises agree on the terms of the sales, including price and credit conditions. The third category includes all remaining products that can be freely traded among enterprises. In practice, however, little is traded free of restraints, as the bulk of trade in value terms is included in the first two categories.

These bilateral agreements fall far short of "solving" the myriad trade and payment problems. To begin with, it is unclear how frequently and exactly how trade imbalances among the states should be settled—convertible currency, rubles, and additional goods shipment have been proposed as means of payment, with payment periods ranging from a month or shorter to a year. There are also significant problems with fulfilling obligatory trade agreements, largely as a result of the continuation of price controls, which reduce the incentive to export. At the same time, the system of state orders has either broken down or become less effective. As a result, enterprises, which either do not find it profitable or lack the needed inputs, often do not supply the agreed-upon quantities. More fundamentally, as long as trade is conducted on the basis of bilateral pacts, it is governments rather than markets that are determining the allocation of resources.

Barter. Another way of coping with the confused trade and payments situation is by resorting to barter—which appears to account for a significant, although impossible to quantify, share of interstate trade for a number of reasons. First, because of provisions in the intergovernmental protocols, price controls are prevalent in interstate trade. Second, there are now high risks and costs associated with using the banking system. Third, arrears between enterprises has been a large problem in most states, and the risk of nonpayment is even greater on interstate sales.

Terms of trade. Superimposed on these problems is a deterioration in the terms of trade for many states, as domestic prices are brought closer to world prices. Preliminary estimates suggest that those hardest hit will be Belarus, Moldova, and the Baltic states, who, depending on the actual pattern and volume of trade, might experience losses of about 10–20 percent of GDP. Furthermore, to the extent that international prices are passed on to final users, activities dependent on underpriced inputs (both in domestic and interstate trade) might need considerable restructuring. By contrast, raw material and energy exporters, such as Russia and Turkmenistan, stand to gain. And others, such as Azerbaijan, Kyrgyzstan, and Uzbekistan seem likely to suffer little or no adverse consequences.

In the end, a terms-of-trade adjustment is unavoidable—indeed it is essential for improving resource allocation and integrating these economies into the world economy. On the other hand, there is a question as to how quickly this adjustment should take place. Already, some states are trying to offset their losses by exploiting whatever monopoly power existing linkages and the transportation network give them.

Proposed transition policies

Experience has shown that, as the states of the former USSR look ahead, growth would be facilitated by the establishment of currencies that are convertible on current account (whether it be a convertible ruble zone or new currencies) and the adoption of a trade regime with low and uniform tariffs—free as much as possible of nontariff barriers—to encourage unregulated trade between enterprises. But the current situation is so far removed from this environment that the key questions now center on how best to shape transitional, often second best, arrangements that nonetheless would bring them closer to their desired longer-term goals.

Trade regime toward third countries. Experience throughout the world suggests that, in general, policies that discourage exports should be avoided. In particular, quantitative restrictions and licensing requirements would need to be removed, and exporters should not be forced to surrender foreign exchange earnings at below market exchange rates. Moreover, export taxes are not needed—except on a temporary basis for those few commodities whose domestic prices are controlled and hence below international prices at prevailing exchange rates. Even for these, export taxes should decline to zero as the domestic price moves toward the world price. If states pursue these policies, they should be able to sharply increase their prized convertible currency earnings, thanks to a higher level of exports and an exchange rate that is very favorable to exporting.

On the import side, as long as enterprises continue to trade with each other for rubles in an environment of an undervalued ruble and central allocation of foreign exchange, import competing industries are highly protected and there is no need for protection from third country imports. However, once the ruble is not undervalued or new currencies are introduced requiring convertible currency settlement among states, the incentive structure will change and domestic industries will face import competition from third countries and reduced demand for exports in the states of the former USSR. At this point, states may wish to provide some interim modest protection to domestic industries in order to ease the process of adjustment and cushion the potential costs of increased unemployment.

If there is to be protection, World Bank experience with trade suggests that it can be best provided through tariffs (not to exceed 20–30 percent) that (1) preferably do not vary by sector, or at least have a narrow high-low range, and (2) would decline over time. Such an approach will obviously result in slower adjustment to the long-run optimum and should not be viewed as an alternative to appropriate exchange rate adjustment. In an environment of uncertainty regarding price and exchange rate movements, however, a modest protective margin, provided through tariffs to industries with positive value-added, may be a useful transition device. Tariffs can also play a limited useful role in generating fiscal revenue during a time when tax revenue collection is not yet fully effective, although given the small share of imports from the rest of the world, the revenue from this taxation will not be large.

But if the tariffs are not moderate, they may actually serve to protect negative value-added industries. This would increase the transition costs, because in negative value-added industries, the economy would save convertible currency by importing the final product, exporting the intermediate inputs, and paying workers even if they did not work. And if the tariffs do not decline over time, they would hamper the full integration of the economies into the world trading environment.

State trading. For decades, this type of trading has seriously impeded the efficient allocation of resources and should be discontinued as soon as domestic prices are freed to adjust to world prices. Bilateral agreements may need to be maintained in interstate trade for only those products subject to price controls. However, such agreements should limit the obligatory list to those few products (e.g., oil and natural gas) that are adjusting to world prices on a gradual basis. Moreover, the agreements should increasingly use state procurement agencies, rather than state orders, to carry out trade in these products. For all other products, states should either stop the use of export licenses or make the licenses automatic, as is the case with the indicative list, and the licenses should not be used to balance accounts on a bilateral basis.

Governments would also want to encourage the entry of new firms in trade operations and eliminate the monopoly position of state trading organizations. This would require steps (e.g., in the availability of trade credit) to ensure that private traders are given equal opportunity to participate in trading activities.

Payments problems. To overcome payments problems that inhibit trade, countries must either adopt a fully coordinated monetary and exchange rate policy within the ruble area, or leave the area and adopt independent currencies.

Arrangements within the ruble zone. Any state wishing to remain in the ruble zone must accept the need to coordinate monetary policy and exercise restraint. For these states, it is vital to agree on the rules regarding seignorage, currency emission, monetary policy, and the levels of outstanding balances that each may be able to maintain. Otherwise, overexpansionary policies in one state could lead to significant negative balances that are automatically financed and result in net transfers of goods and services from the others without the receipt of convertible currency.

Measures will also be needed to reduce delays in processing payments orders and improve the efficiency of settlement procedures for ruble zone trade. In addition, commercial banks in each country should be allowed to establish correspondent bank accounts in the commercial banks of the others.

For countries with new currencies. Since these new currencies may be inconvertible for a time, there is a danger that barter will continue to dominate and enterprise-to-enterprise transactions will not materialize. Thus, a system of multilateral clearing with short settlement periods (a clearing union) should be introduced. Such a system would economize on the use of hard currency reserves by permitting transactions at the enterprise level to be conducted in national currencies. Only the multilateral balance within the union would be settled in convertible currency among participating central banks.

In early 1993, an alternative approach—using the ruble for settlement—was being considered by nine countries (excluding the Baltic states, Azerbaijan, Georgia, and the Tajikistanian Republic), in the context of negotiations for setting up an Interstate Bank. This bank, which at least in the beginning is not intended to play a monetary role, will have as its main objective the establishment of an institutional mechanism for multilateral clearing and settlement of interstate payments, based on a short settlement period and strict credit limits. Since different exchange rates are emerging for different "national" rubles and countries such as Ukraine are considering participation, the Interstate Bank may emerge essentially as a multilateral clearing house for countries with different currencies, rather than a ruble zone institution. Although it may fall short of including all new independent states and many of its features are clearly transitional, the Interstate Bank may serve a useful role in addressing the urgent need for establishing a regional multilateral clearing mechanism.

However, more elaborate payments arrangements that involve long settlement periods and the provision of substantial external credit (patterned after the postwar European Payments Union) are not recommended. Such arrangements raise questions as to whether the credits provided finance a structural deficit or the outcome of ineffective overall macroeconomic policies. They may also tend to discourage a movement toward convertibility and future integration into the world economy.

Interstate trade policy. At the very minimum, interstate trade relations should avoid beggar-my-neighbor policies that result in diminution of total trade in goods and services among the 15 states. The movement to world prices will undoubtedly lead to the deterioration of the terms of trade of a number of states, especially oil importers. But this can be mitigated in part by Russia providing energy supplies to other states at domestic oil and gas prices that could be expected to be adjusted to world oil prices in the near term. In parallel, energy-importing states should eschew the temptation of trying to compensate by exploiting monopolistic positions in other areas, such as transportation.

More broadly, the recommended transition tariffs should not be applied to the states of the former USSR—that is, it may be worthwhile to try to set up a customs union or free trade arrangement on a temporary basis. By providing moderate tariff preferences, such an arrangement could provide a modest incentive for maintaining interstate trade in the near future, thereby reducing unemployment costs during the transition.

A few guidelines would include: (1) allowing all states to join, irrespective of whether they desire to remain in the ruble zone—in fact, given the excessive incentive to import from within the ruble zone, the preferential trade pact would only be important for trade among those states with different currencies; and (2) reducing the tariff against third countries and eliminating tariff preferences over time to permit the various states to adjust to their long-run comparative advantage in international trade, which involves less trade dependence on each other.

If a broad-based agreement cannot be arranged, however, more narrow ones, such as a customs union among the Baltic states, may be worth exploring, and different groupings may want to establish different arrangements. The nature of the arrangements could vary, but the more comprehensive the arrangement, the more likely that it will help reduce transition costs in the medium term. Moreover, individual states, especially small ones, may choose not to join any preferential trade area because they regard the trade diversion costs as excessive (i.e., for the range of products they import, they would have to pay high prices to tariff-favored, intra-union, high-cost suppliers). However, they would need to consider the implications of not having preferential access to the area.

Next steps

In sum, as the states of the former USSR design transitional trade and payments arrangements, they will have to contend with a daunting list of intricately linked problems. Perhaps the top priorities should be:

- the reduction of state trading and the simultaneous expansion of enterprise-to-enterprise transactions;
- the elimination of disincentives to exports, such as licensing and other quantitative controls;
- the establishment of a satisfactory system of payments based either on a fully coordinated monetary policy within the ruble zone, or the adoption of new currencies; and
- the establishment of suitable multilateral clearing and payments mechanisms, both within the ruble zone and among the states with new currencies—otherwise, barter will continue to dominate.

It would be especially helpful if Russia were to take the lead in these matters because of the central role it plays in trading relations with all the states in the region. ■

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